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## Defining Domestic Industry in the Tariff Act of 1930: Removing the Gremlins From Section 337

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# Defining Domestic Industry in the Tariff Act of 1930: Removing the Gremlins From Section 337

Martin B. Schwimmer

## **Abstract**

Part I of this Note discusses the proposals before Congress and the importance of section 337 as an import relief statute. Part II discusses the judicial development of the current definition of domestic industry. Part III analyzes the efficacy of the proposed definition in combating the problem cases that led to the existing dispute.

# DEFINING DOMESTIC INDUSTRY IN THE TARIFF ACT OF 1930: REMOVING THE GREMLINS FROM SECTION 337

## INTRODUCTION

The United States Congress is now considering proposals<sup>1</sup> to insert a definition of a "domestic industry"<sup>2</sup> in Section 337 of the Tariff Act of 1930,<sup>3</sup> the import relief law that protects U.S. domestic industry from unfair trade practices.<sup>4</sup> The proposals, included in the Omnibus Trade Bill of 1987,<sup>5</sup> are a response to recent International Trade Commission ("ITC" or "Commission") decisions that barred relief to off-shore manufacturers<sup>6</sup> and licensing companies<sup>7</sup> because they were found

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1. S. 490, 100th Cong., 2d Sess. (1987); H.R. 3, 100th Cong., 2d Sess. (1987).

2. Although the statute reads "industry, efficiently and economically operated, in the United States," 19 U.S.C. § 1337(a) (1982), the passage is referred to as the domestic industry requirement.

3. Tariff Act of 1930, ch. 497, § 337, 46 Stat. 703 (codified as amended at 19 U.S.C. § 1337 (1982 & Supp. III 1985)). Subsection (a) of the statute prohibits [u]nfair methods of competition and unfair acts in the importation of articles . . . the effect or tendency of which is to destroy or substantially injure an industry, efficiently and economically operated, in the United States, or to prevent the establishment of such an industry, or to restrain or monopolize trade and commerce in the United States . . . .  
19 U.S.C. § 1337(a) (1982).

4. Reintroducing his amendment, Senator Frank Lautenberg (D- N.J.) pointed out that

[w]ith disturbing frequency, foreign firms pirate American inventions, and then ship those products back here. The International Trade Commission estimated, back in 1982, that infringement of U.S. intellectual property cost Americans 131,000 jobs, in just five selected industrial sectors. Piracy cost the Nation's businesses \$5.5 billion in annual sales. Estimates of total losses now range from \$8 to \$20 billion.

133 CONG. REC. S1794 (daily ed. Feb. 4, 1987); see text accompanying notes 12-17.

5. The amendment reads as follows:

(3) For purposes of paragraph (2), an industry in the United States shall be considered to exist if there is in the United States with respect to the articles protected by the patent, copyright, trademark, or mask work concerned—

(A) significant investment in plant and equipment;

(B) significant employment of labor or capital; or

(C) substantial investment in its exploitation, including engineering, research and development, or licensing.

H.R. 3, 100th Cong., 2d Sess., 133 CONG. REC. H2898 (daily ed. Apr. 30, 1987).

6. *In re Certain Miniature, Battery-Operated, All-Terrain, Wheeled Vehicles*, 4 I.T.R.D. (BNA) 1920 (Int'l Trade Comm'n 1982) [hereinafter *Toy Trucks*], *aff'd sub nom.* Schaper Mfg. Co. v. U.S. Int'l Trade Comm'n, 717 F.2d 1368 (Fed. Cir. 1983).

not to be part of a domestic industry, that is, an industry in the United States as required by section 337.

Currently, the Commission finds complainants to be part of a domestic industry and therefore able to proceed with a complaint if they satisfy what is known as the "nature and significance" test, first articulated in the *Toy Trucks* case.<sup>8</sup> The Commission looks at the nature of the domestic activity in the context of the industry in question and determines whether such domestic activities constitute a significant proportion of the total production process.<sup>9</sup> The amended statute would define domestic industry as, *inter alia*, one where a significant investment through research and development, engineering, or licensing has been made in articles protected by intellectual property.<sup>10</sup> This Note argues that section 337 in its proposed form would provide much needed protection to intellectual property holders currently denied relief by ITC precedent. However, the expanded definition of domestic industry creates the possibility that foreign-owned entities may use section 337 as an anti-competitive weapon against other importers. Part I of this Note discusses the proposals before Congress and the importance of section 337 as an import relief statute. Part II discusses the judicial development of the current definition of domestic industry. Part III analyzes the efficacy of the proposed definition in combating the problem cases that led to the existing dispute. This Note concludes that the new definition of domestic industry does what needed to be done: it delineates between importer and domestic industry. However, the new section 337 will require careful monitoring by the ITC to prevent it from becoming an importer's forum.

## I. DEFINING A DOMESTIC INDUSTRY

### A. Section 337 of the Tariff Act of 1930

Section 337 forbids "[u]nfair methods of competition and unfair acts in the importation of articles into the United States" that injure or have the tendency to injure an industry

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7. *In re Certain Prods. with Gremlins Character Depictions*, 8 I.T.R.D. (BNA) 1585 (Int'l Trade Comm'n 1986) [hereinafter *Gremlins*].

8. See *Toy Trucks*, *supra* note 6, at 1935.

9. *Id.*

10. See *supra* note 5.

efficiently and economically operated<sup>11</sup> in the United States.<sup>12</sup> As such, section 337 is one of the statutes increasingly invoked by a domestic producer when confronted with unfair competition by imports.<sup>13</sup>

To begin a section 337 action, the complainant must prove three elements.<sup>14</sup> First, complainant must establish that the defendant used unfair practices, such as copyright infringement,<sup>15</sup> trademark violation,<sup>16</sup> or predatory pricing.<sup>17</sup> Second, complainant must show that the unfair practices tend to "destroy or substantially injure" an industry.<sup>18</sup>

The third element requires the complainant to establish the existence of an industry operated in the United States.<sup>19</sup> Although this element is essentially a question of standing, it is crucial for another reason: the larger the industry, the harder it is for the complainant to satisfy the injury requirement.<sup>20</sup> Most importantly, the scope of domestic industry determines who is

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11. The Omnibus Trade Bill contains additional amendments to Section 337 that would remove the "efficiently and economically operated" language from the statute. See S. 490, 100th Cong., 2d Sess. (1987); H.R. 3, 100th Cong., 2d Sess. (1987). No case has ever turned on this requirement. See Farkas & Chubb, *Section 337 and Proposals to Amend It: A Practitioner's Perspective*, 32 Pat. Trademark & Copyright J. (BNA) 180 (June 19, 1986). The requirement may still be taken into account by the Commission in its public interest determination. See Farkas, *Tariff Act Changes Portend More Harm than Good*, LEGAL TIMES, Apr. 7, 1986, at 29.

12. 19 U.S.C. § 1337 (1982 & Supp. III 1985).

13. Note, *An Argument for Freer Trade: The Nonmarket Economy Problem Under the U.S. Countervailing Duty Laws*, 17 INT'L L. & POL. 407 (1985).

14. 19 U.S.C. § 1337 (1982 & Supp. III 1985).

15. See *Gremlins*, *supra* note 7.

16. *In re Certain Airtight Cast Iron-Stoves*, 3 I.T.R.D. (BNA) 1158 (Int'l Trade Comm'n 1981) [hereinafter *Cast-Iron Stoves*].

17. *In re Certain Welded Stainless Steel Pipe and Tube*, ITC inv. no. 337-TA-29, pub. 863 (Int'l Trade Comm'n Feb. 22, 1977).

18. 19 U.S.C. § 1337(a) (1982). Factors considered include significant displacement of customers, decline in employment and productivity, and decline in production of a domestic article resulting from sales lost due to the unfair acts. Note, *Litigating Unfair Trade Practices Under Section 337(a) of the Tariff Act of 1930: Defining the Domestic Industry*, 16 LAW & POL'Y INT'L BUS. 597, 598 (1984).

Usually, injury depends upon evidence pertaining to production levels, prices, profitability, capacity utilization, employment levels, and other objective indicia of the industry's health. *Id.*

19. Note, *supra* note 18, at 598.

20. Applebaum, *What Is a "Domestic Industry" for Purposes of Application of the United States Trade Laws?*, in INTERNATIONAL TRADE POLICY: THE LAWYER'S PERSPECTIVE 13-2 (1985).

to receive the limited resource of a section 337 action's swift justice. This is the core of the current dispute.

### B. *The Congressional Proposal to Amend Section 337*

The number of section 337 actions is predicted to increase dramatically over the next few years.<sup>21</sup> Section 337 is increasingly popular for several reasons. First, adjudication of a section 337 action is much faster than that of a civil infringement suit. Speedy adjudication of unfair trade practices is particularly valuable in the case of a short-lived industry,<sup>22</sup> such as Pac-Man video games<sup>23</sup> or Gremlin character souvenirs.<sup>24</sup> Second, section 337 is the only statute that provides relief from foreign infringement of a patented process.<sup>25</sup> Third, when other import relief statutes, such as countervailing duty and antidumping laws are inappropriate, section 337's broad prohibition of unfair acts and unfair methods makes it a catch-all statute.<sup>26</sup>

The proposed definition before Congress expands section 337's coverage by specifying that a domestic industry can be found where there has been a significant investment by a company in the exploitation of intellectual property through research and development, engineering, or licensing.<sup>27</sup> Section 337 currently contains no definition of domestic industry, but case law has produced a "nature and significance" test, popularly known as the *Toy Trucks* test;<sup>28</sup> the Commission first examines the nature of the complainant's domestic activity in the context of the industry in question. The Commission then determines whether such domestic activities form a significant

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21. Brunsvold & Alberstadt, *Bills Aim to Better Protect U.S. Intellectual Property*, LEGAL TIMES, Nov. 11, 1985, at 13.

22. Schaumberg, *Section 337 of the Tariff Act of 1930 as an Antitrust Remedy*, 27 ANTITRUST BULLETIN 50 (1982).

23. *Bally/Midway Mfg. Co. v. United States Int'l Trade Comm'n*, 714 F.2d 1117 (Fed. Cir. 1983).

24. See *Gremlins*, *supra* note 7.

25. Note, *Importation of Articles Produced by Patented Processes: Unfair Trade Practices or Infringement*, 18 GEO. WASH. J. INT'L & ECON. 129 (1984).

26. See Brandt & Zeitler, *Unfair Import Trade Practice Jurisdiction: The Applicability of Section 337 and the Countervailing Duty and Antidumping Laws*, 12 LAW & POL'Y INT'L BUS. 95, 97 (1980); see also Note, *supra* note 18, at 598.

27. See S. 490, 100th Cong., 2d Sess. (1987); H.R. 3, 100th Cong., 2d Sess. (1987); *supra* note 5.

28. See *Toy Trucks*, *supra* note 6, at 1935.

enough proportion of the total production process, so that the complainant is part of a domestic industry.<sup>29</sup>

The "nature and significance" test causes confusion and controversy over how much is significant and what is significant. The Commission has never spelled out just how much domestic activity is a significant enough proportion of total value added to the product, the result being that each decision seems to be fact-specific.<sup>30</sup> Additionally, the Commission is bitterly divided over which non-manufacturing activities to include in its determination.<sup>31</sup> Traditionally, only manufacturing operations have been included in the Commission's definition.<sup>32</sup> However, beginning with the *Cast-Iron Stoves* case in 1981,<sup>33</sup> the Commission began including service operations, such as installation and distribution, in the definition. Currently, the Commission distinguishes production-related operations from "buyer-assistance" services such as advertising, and includes only production-related operations in its definition.<sup>34</sup>

The dispute over section 337's coverage creates questions of standing<sup>35</sup> for two problem complainants in particular. The question arises whether a service industry, such as a licensing company, constitutes a domestic industry, and further, whether a manufacturer with off-shore manufacturing contributes significant value-added services in the United States to constitute a domestic industry. The geographical and organizational separation of the manufacturing process from the service process in many companies gives rise to this problem.<sup>36</sup>

While the *Toy Trucks* "nature and significance" test was a

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29. It is within the province and the expertise of the ITC to define the phrase "domestic industry," and the Court of Appeals' function on appeal is to decide whether the Commission's definitions are reasonable in light of language, policies, and legislative history of the statute. *Corning Glass Works v. U.S. Int'l Trade Comm'n*, 799 F.2d 1559 (Fed. Cir. 1986).

30. Compare *Toy Trucks*, *supra* note 6, with *In re Cube Puzzles*, 4 I.T.R.D. (BNA) 2102 (Int'l Trade Comm'n 1983). See generally text accompanying notes 49-66.

31. See *Cube Puzzles*, *supra* note 30, at 2119 (additional views of Com'r. Stern).

32. See, e.g., *Frischer & Co. v. Bakelite Corp.*, 39 F.2d 247 (C.C.P.A. 1930); see also text accompanying note 44.

33. See *Cast-Iron Stoves*, *supra* note 16.

34. See *Toy Trucks*, *supra* note 6.

35. Applebaum, *supra* note 20, at 13-3.

36. Lupo & Tanguay, *The Domestic Industry Requirement of Section 337: A Definitional Problem in View of Off-Shore Manufacture*, 66 J. PAT. OFF. SOC'Y 551, 551-52 (1984).

flexible tool of the ITC, and well regarded by some commentators,<sup>37</sup> calls for amending the statute gained support in Congress when the ITC began denying relief to ostensibly American companies.<sup>38</sup> The perception grew that such decisions were disincentives to the creation and exploitation of intellectual property.<sup>39</sup>

Against the background of this perception and the protectionist mood in Congress caused by the nation's huge trade deficit, legislation was reintroduced in February of 1987 to put a definition of domestic industry into section 337.<sup>40</sup> The proposal passed the House on April 30, 1987,<sup>41</sup> and the Senate on July 25, 1987.<sup>42</sup> It now awaits presidential approval.

## II. THE EVOLUTION OF THE DEFINITION OF "DOMESTIC INDUSTRY"

### A. *The Manufacturing Orientation of Section 337*

Faced with complainants who are not easily categorized as either importer or domestic company, the ITC has struggled in recent years to fashion a workable definition of domestic industry. The "nature and significance" test has never been fully accepted by the ITC,<sup>43</sup> has been inconsistently applied, and is

37. Applebaum, *supra* note 20, at 13-10.

38. For example, when H.R. 3, *supra* note 1, was re-introduced this year, Senator Lautenberg criticized ITC decisions on the floor of Congress: "Current law throws up barriers that have blocked relief for a range of firms; from the New York inventor of fibre optic waveguide; to the California movie studio that licenses the Gremlin character." 133 CONG. REC. S1794 (daily ed. Feb. 4, 1987).

39. See *Toy Trucks*, *supra* note 6, at 1937; see also *Gremlins*, *supra* note 7, at 1604.

40. See Remarks of Sen. Lautenberg, 133 CONG. REC. S1794 (daily ed. Feb. 4, 1987). Additionally, 782 trade bills and resolutions were pending before the 99th Congress at the end of June 1986. According to one study, 248 of these contained explicit protectionist provisions, while one out of every four proposed trade restrictions for political rather than economic purposes. Only 184 were aimed at liberalizing trade. *General Developments: Import Policy*, 3 Int'l Trade Rep. (BNA) 1047 (Aug. 13, 1986).

41. See 133 CONG. REC. H2898 (daily ed. April 30, 1987).

42. *General Developments: Intellectual Property*, 4 Int'l Trade Rep. (BNA) 1047 (July 29, 1987). As a relatively uncontroversial part of the Omnibus Trade Bill, which contains the controversial Gephardt Amendment, predicted to be vetoed by President Reagan, the section 337 proposals' best chance of becoming law is as stand-alone legislation. Approval is expected by the end of 1987. *Id.*

43. See, e.g., *Gremlins*, *supra* note 7, at 1601 (Liebeler, Vice Chairwoman, dissenting) ("nature and significance" test insufficient for modern, information based, economy).



inappropriate when applied to licensing companies.

For its first fifty years section 337 was a manufacturer's statute, and "domestic industry" referred only to the manufacturing operations of the complainant.<sup>44</sup> However, as U.S. industry became more service oriented, the Commission did not consider itself bound by legislative intent to specifically favor manufacturing operations over other production activities.<sup>45</sup> In the landmark *Cast-Iron Stoves* decision in 1981, the Commission found the room to include service industries in the definition of domestic industry, thus recognizing their increasing importance in the American economy.<sup>46</sup>

*Cast-Iron Stoves* marked the start of the struggle to create a bright-line distinction between importers and domestic companies, a distinction the current proposal purports to set forth.

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44. Past Commission decisions have defined "domestic industry" in section 337 investigations, based upon claims of patent infringement, as the domestic manufacture or production of the patented infringement, as the patentee or his licensee. Legislative histories of section 316 [the predecessor statute to section 337] of the Tariff Act of 1922 and of section 337 of the Tariff Act of 1930 also indicate that the intent of the statute was the protection of domestic manufacturers of goods. Sirilla, *A View of the United States International Trade Commission as a Forum for Suits by Domestic Importers of Products Made Abroad*, 65 J. PAT. OFF. SOC'Y 47, 50 (1983).

The theory that section 337 was a production-oriented statute is developed by the *Walkie-Talkie* case. In 1965, a California corporation, which owned a patent for electronic circuitry but manufactured the circuitry abroad, brought an action against the defendant for importing walkie-talkies with infringing circuitry. The complaint was dismissed because the patented circuits were not produced in the United States by or on behalf of the complainant, but rather are obtained by complainant from abroad. Section 337 did not apply in this case, because there was no industry in the United States producing the patented circuits. *In re Walkie Talkie Units*, Notice of Dismissal, 30 Fed. Reg. 15,243 (1965).

45. In *Cast-Iron Stoves*, the Commission noted that:

[T]he legislative histories of both Section 316 of the 1922 Act and Section 337 of the 1930 Act are unhelpful regarding the meaning of the term "industry." At the time of the adoption of both sections, the dominant economic activity in the United States was manufacturing. Congress anticipated that the great majority of cases brought under section 337 would involve manufacturing industries. However, there is some indication that the law was not intended to be limited to the protection of manufacturing activity. In the floor debate on the 1922 law, Mr. Fordney, one of the principal sponsors of the act, referred to industries as including farming and mining as well as manufacturing. During the Senate debates on the 1930 act, Senator Simmons stated that Section 337 applies "to all industries alike. Wage earner, farmer, stockman, producer, and legitimate business in general have everything to gain."

*Cast-Iron Stoves*, *supra* note 16, at 1161-62 (footnotes omitted).

46. Note, *supra* note 18, at 612.

The Commission defined "domestic industry" as "systematic activity which significantly employs American land, labor, and capital for the creation of value."<sup>47</sup> Thus, the Commission found that a company that installed coal and wood-burning stoves that were completely manufactured abroad was part of a domestic industry.<sup>48</sup>

### B. *Toy Trucks Rides Into The Picture*

Fearful of a misuse of a broad definition of domestic industry, the Commission retreated from the expansive *Cast-Iron Stoves* test in *Certain Miniature, Battery Operated, All Terrain Vehicles*<sup>49</sup> (*Toy Trucks*). The Commission adopted a two-step test in which it first considers the nature of the complainant's domestic activities in the context of the particular industry, and then determines whether the complainant's activities constitute a significant enough proportion of the total production process to justify including the complainant in the domestic industry.<sup>50</sup>

The important distinction made in the *Toy Trucks* test is between production-related activities and buyer-assistance activities, such as advertising and marketing.<sup>51</sup> The rationale for

47. *Cast-Iron Stoves*, *supra* note 16, at 1162.

48. In *Cast-Iron Stoves*, the U.S. subsidiary of a Norwegian stove manufacturer alleged violations of common law trademark rights, passing off, false advertising, and violation of federally registered U.S. trademarks. *Id.* at 1159-60. The subsidiary's U.S. activities consisted of testing, repairing, warehousing, and installing the stoves, and preparing advertising and service manuals. *Id.* at 1162.

The Commission found that a domestic industry existed, consisting "of that segment of the entire . . . industry which was the target of the unfair acts and practices, i.e., Jotul U.S.A., its distributors and dealers." *Id.* at 1161. The complainant's substantial repair and installation activities employed a significant amount of U.S. labor. *Id.* at 1162-63.

49. *In re Certain Miniature, Battery-Operated, All-Terrain, Wheeled Vehicles*, 4 I.T.R.D. 1920 (BNA) (1982), *aff'd sub nom.* Schaper Mfg. Co. v. U.S. Int'l Trade Comm'n, 717 F.2d 1368 (Fed. Cir. 1983).

50. *Id.* at 1935. Commissioner Haggart added that:

It is suggested that in considering the nature and sufficiency of a complainant's activities in the United States, the following activities would be relevant: design, research and development, tooling, manufacture, assembly, quality control or packaging. This list is not intended to be all-inclusive, but merely illustrative.

*Id.* at 1935, n.5; see also Applebaum, *supra* note 20, at 13-6 to 13-9.

51. In distinguishing *Cast-Iron Stoves*, the Commission noted that installation of stoves is integrally related to the product, while marketing is an assist to the consumer often provided by a buyer of imported merchandise. *Toy Trucks*, *supra* note 6, at 1935 & n.6.

the distinction was that any firm, whether importer or domestic industry, has to incur marketing expenses in the United States.<sup>52</sup> The Commission's ability to assess the relative importance of the domestic activity in the context of its industry makes the *Toy Trucks* test much more flexible than a simple test for domestic value added.<sup>53</sup>

The test's flexibility is demonstrated by the Commission's decision in *Floppy Disk Drives*.<sup>54</sup> Complainant Tandon Computers' domestic activities constituted a lower percentage of the product's total value than was normally considered significant in other cases. However, the Commission held that, because of the nature of research and development and engineering in an important high-tech field such as personal computers, those activities were significant enough to qualify Tandon as part of a domestic industry.<sup>55</sup>

The *Toy Trucks* "nature and significance" test, however, has been administered in an inconsistent fashion. In *Toy Trucks*, for example, the ITC found that the random quality control, advertising, and distribution expenses incurred by the Minnesota complainant on toy trucks manufactured and packaged for it in Hong Kong were of a buyer-assistance nature, and therefore not significant production-related activities that would qualify the firm as part of a domestic industry.<sup>56</sup> In contrast, in *Cube Puzzles*, which presented virtually identical facts to

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52. *Id.* at 1935.

53. Lupo & Tanguay, *supra* note 36, at 568.

54. *In re Certain Double-Sided Floppy Disk Drives*, 8 I.T.R.D. (BNA) 2277 (Int'l Trade Comm'n 1986).

55. *See id.* at 2285 (additional views of Chairwoman Stern), 2288 n.3 (additional views of Vice-Chairwoman Liebler).

56. Complainant Goldfarb, a California inventor of a design for a toy truck, and his Minnesota licensee, Schaper, brought a patent infringement claim against Soma Traders, Ltd., who, like Schaper, imported toy trucks from Hong Kong. *Schaper Mfg. v. U.S. Int'l Trade Comm'n*, 717 F.2d 1368, 1369-70 (Fed. Cir. 1983). Complainant's trucks were manufactured in Hong Kong by a separate company, imported in final form, and sealed in "blister packs." *Id.* at 1370. Schaper owned and paid for all the tooling used in the manufacture and maintained regular communication with the Hong Kong company. *Id.* Schaper conducted limited quality-control (of a random sampling), marketing, advertising, and distribution activities domestically. *Id.* at 1372-73.

The Commission decided that the advertising and sales activities were not a significant portion of the production process. *Id.* at 1373. Commissioner Frank, in dissent, rejected an integrally-related activity test, and instead emphasized an analysis of all economic factors. *Toy Trucks*, *supra* note 6, at 1936-37. The Commissioner argued

those of *Toy Trucks*, the Commission found a domestic industry.<sup>57</sup> In *Cube Puzzles*, Ideal, a toy company headquartered in the U.S., imported Rubik's Cubes for one dollar and added ninety-two cents to their cost in the form of testing, quality control,<sup>58</sup> repair, and packaging.<sup>59</sup> The Commission distinguished the quantity of Ideal's quality control from that of *Toy Trucks*'s in that Ideal rejected one million out of sixteen million cubes, while the complainant in *Toy Trucks* conducted only random quality sampling.<sup>60</sup> A commentator has suggested that the existence of Ideal's 200-employee domestic cube facility aided in the finding of a domestic industry.<sup>61</sup>

Commissioner Stern's dissent in *Cube Puzzles* further illustrates the problem of drawing a distinction between production-related and buyer-assistance activities.<sup>62</sup> Commissioner

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that the capital investment involved and marketing was the significant factor, outweighing the value of the off-shore manufacturing. *Id.* at 1936.

On appeal, the Federal Circuit agreed with Commissioner Frank that total value should be considered, making primarily service industries eligible. Schaper Mfg., 717 F.2d at 1373. Complainant Schaper seemed to lose not because of criteria of the test, but because of the weight the Court gave certain criteria. Lupo and Tanguay, *supra* note 36, at 561-62. The court endorsed the "service industry" concept. Applebaum, *supra* note 20, at 13-8. However, they found against Schaper:

Although we agree that in proper cases "industry" may encompass more than the manufacturing of the patented item, we also believe that the Commission did not err in deciding that Schaper's activities in the United States are too minimal to be considered an "industry" under Section 337. There is simply not enough significant value added domestically to the toy vehicles by Schaper's activities in this country (including design, inspection and packaging).

717 F.2d at 1373.

57. The Commission described its analysis:

In reaching her decision in the instant case, Commissioner Haggart has applied the two-step process described therein. She has first looked at the nature of the domestic activity in the context of the characteristics of the cube puzzle industry. She has then compared the extent of such domestic activities with the total production process in order to determine whether sufficient production activities are performed in the United States. Utilizing this analysis and in light of the facts of this case, she has concluded that Ideal's domestic activities are sufficient to constitute "an industry . . . in the United States."

*Cube Puzzles*, *supra* note 30, at 2114 n.98.

58. Including the "Life" test where employees turn the cubes for several hours. *Id.* at 2115 n.108.

59. *Id.* at 2115.

60. *Id.* at 2114, 2115 n.109.

61. Applebaum, *supra* note 20, at 13-10.

62. *Cube Puzzles*, *supra* note 30, at 2118-19 (Stern, Comm'r, dissenting).

Stern found that Ideal's situation was indistinguishable from that of the complainant in *Toy Trucks*.<sup>63</sup> While the majority held that Ideal's packaging added significant production-related value to the Cube,<sup>64</sup> Commissioner Stern cited the testimony of an Ideal executive, who stated that the package of the Cube was an extension of its marketing and advertising. By deducting the packaging expenses from the ninety-two cents figure, Commissioner Stern concluded that Ideal's significant value added was *de minimis*.<sup>65</sup>

Furthermore, although Commissioner Stern did not dispute the *Toy Trucks* test as the proper means of analysis, she did voice the concern that, without a rigorous test, section 337 actions could become a forum for importers whose sales and distribution activities constitute a significant part of the total cost.<sup>66</sup>

### C. Gremlins in the "Nature and Significance" Test

Despite its flaws, the *Toy Trucks* test is a flexible tool for analysis of cases involving off-shore manufacturers. However, when the ITC applied the test in the *Gremlins* case to a licensing company that had no product in the traditional sense of the word, the test proved wholly inappropriate.<sup>67</sup> The resulting decision barring relief was unpopular<sup>68</sup> and was singled out in Congress as a reason for the current amendment of section 337.<sup>69</sup>

Citing *Toy Trucks* and section 337's legislative history, the Commission held in *Gremlins* that intellectual property is not within section 337's coverage and is not an article of commerce upon which production-related activity can be performed.<sup>70</sup>

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63. *Id.* at 2118 (Stern, Comm'r, dissenting).

64. *Id.* at 2115-16.

65. *Id.* at 2118-19 (Stern, Comm'r, dissenting).

66. *Id.* at 2118 (Stern, Comm'r, dissenting).

67. See generally *Gremlins*, *supra* note 7.

68. See *Gremlins*, *supra* note 7, at 1599-1604 (Liebeler, Comm'r, dissenting) (whether a licensing industry can be a domestic industry within the meaning of section 337).

69. See 133 CONG. REC. S1795 (remarks of Senator Lautenberg).

70. The Commission reviewed legislative history in *Gremlins*:

It is clear from section 337, its legislative history, past Commission decisions, and [*Toy Trucks*] that section 337 protects domestic industries, not importers or inventors. Although some *Gremlins* products are produced do-

Therefore the ITC did not apply the "nature and significance" test at all, although the activities of the complainant, the Licensing Corporation of America ("LCA"), were thoroughly discussed and analyzed.<sup>71</sup>

The importer's forum question, debated in the footnotes of *Cube Puzzles*, blossomed into the prime reason why the Commission held that intellectual property licensing was not within section 337, and why licensing companies such as LCA could not be part of a domestic industry.<sup>72</sup> The Commission, after

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mestically, the ALJ did not define the domestic licensing industry to include the licensees' production-related activities. The ALJ defined the domestic licensing industry to include solely Warner's licensing activities . . . .

Moreover, in *Cast-Iron Stoves*, the Commission based its determination on the assembly and installation of the trade-marked products, i.e., the stoves, not on the servicing or licensing of the intellectual property rights. Assembly and installation of the imported stoves, therefore, were integrally related to the product.

*Gremlins*, *supra* note 7, at 1588-89 (footnotes omitted).

71. Warner Brothers brought suit to forestall the flood of infringing Gremlins merchandise that began even before the film *Gremlins* was released. 1 Int'l Trade Rep. (BNA) 238 (1984). In its review of the ALJ's determination, the ITC rejected the Administrative Law Judge's use of a *Cast-Iron Stoves* test. *Gremlins*, *supra* note 7, at 1588. After reviewing the line of cases from *Bakelite* to *Schaper*, the Commission concluded that section 337's legislative history indicates it does not include licensing activities. *Id.* at 1589. Licensing activities were not integrally related to the product within the meaning of section 337. *Id.*

72. The studio urged the ITC to take immediate action against the allegedly infringing goods lest "the short-lived market for the legitimate Gremlins merchandise licensed by Warner Bros. and manufactured by its licensees be substantially injured or destroyed by the infringing imports." 1 Int'l Trade Rep. (BNA) 238 (1984). Goods such as Gremlin plastic dolls, puffy stickers, lapel buttons, and visor caps began appearing almost simultaneous with the opening of the movie *Gremlins*. *Id.* at 238-39. Similar infringement had been charged regarding depiction of characters in films such as *E.T.*, *Star Wars*, and *Star Trek*. *Id.* at 238.

The studio named as respondents eighteen manufacturers, nearly all located in Taiwan, and fourteen importers, all of whom were located in New York. *Id.* at 239. Warner Bros. alleged in the complaint that the infringing merchandise "will, in a very short time, cause the very same dilution of the market for the copyrighted merchandise that Warner Bros. and its licensees have so carefully sought to avoid." *Id.*

The ALJ initially suspended the investigation. 2 Int'l Trade Rep. (BNA) 1372 (1985). After the ITC reversed, the ALJ ruled that Warners owned three copyrights that were infringed, one covering the movie, and one each for the characters Gizmo and Stripe. 3 Int'l Trade Rep. (BNA) 167 (1986). Access wasn't proven but there was a striking similarity that constituted sufficient circumstantial evidence to demonstrate that respondents had access to and used complainant's work. *Gremlins*, *supra* note 7, at 1588.

The ALJ noted that the wide variety of Gremlin products created a problem concerning industry definition. 2 Int'l Trade Rep. (BNA) 1372 (1985). The widest possible industry would include "domestic manufacture, distribution, and sale of the

reviewing LCA's activities in developing, licensing, and marketing the copyrights of the characters in the film *Gremlins*, revealed its concern regarding a broad *Toy Trucks* test: anything LCA did could be done by an importer.<sup>73</sup> Therefore, importers could exploit a holding that granted LCA standing to bring a section 337 action.<sup>74</sup>

In her stinging dissent, Commissioner Liebeler suggested that the majority holding was based on a Luddite<sup>75</sup> fear of intellectual property and service processes.<sup>76</sup> The majority decision, however, suggests that the *Toy Trucks* test, as applied to this new sort of complainant, was simply inappropriate.<sup>77</sup> The Commission reasoned that if the manufacturing slant of the definition was inadequate, it was up to Congress, and not the ITC, to expand the statute.<sup>78</sup>

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products licensed to include depictions of the Gremlins characters on or in association with those products." *Id.*

According to the ALJ, "land, labor, and capital devoted to a service industry, as well as to an industry of manufactured goods, can constitute a domestic industry." *Gremlins*, *supra* note 7, at 1588.

73. The Commission continued:

If Warner's and the ALJ's proposed definition of this domestic licensing industry were adopted by the Commission, a foreign producer could obtain a U.S. copyright, produce all of the products abroad without adding any production-related value to the products or engaging in any production-related activities in the United States, and still be a domestic industry based on extensive marketing and legal activities (to protect the copyright) in the United States.

*Id.* at 1589.

74. See *supra* text accompanying notes 91-105 (discussion of importer's forum).

75. "The Luddites were a band of early 19th century workmen who destroyed labor-saving machinery. They were named after Ned Lud, who broke up stocking frames in the late 18th century." *Gremlins*, *supra* note 7, at 1600 n.8. (Liebeler, Comm'r, dissenting).

76. *Id.* at 1600 (Liebeler, Comm'r, dissenting). Liebeler reveals the problem of using the "Luddism" theory of explanation when she admits that "[a]ll references in this opinion to the reasoning of the majority are based on conjecture. Some members of the Commission will not exchange draft opinions and I have not seen the majority opinion." *Id.* at 1599 n.1.

77. *Id.* at 1589-90.

78. The ITC in *Gremlins* cited the Federal Circuit decision in *Toy Trucks*:

Congress did not intend to protect the activities of importers when it enacted section 337. As the CAFC stated in [*Toy Trucks*]: "If, as appellants suggest, present-day 'economic realities' call for a broader definition to protect American interests (apparently including many of today's importers), it is for Congress, not the courts or the Commission, to legislate that policy." . . . Because these activities relate solely to the servicing of the intellectual property rights in question and are not the type of activities that Con-

### III. THE PROPOSED DEFINITION: AN ANALYSIS

Through its explicit inclusion of exploitation of intellectual property through research and development, licensing, and manufacturing, the proposed definition lays to rest concerns whether the Tariff Act of 1930 was ever intended to cover non-manufacturing operations. The new definition bolsters the ITC's ability to protect intellectual property rights and provides a mandate to the Commission regarding the importance of innovation and competition, even in cases where no domestic manufacturing jobs are directly affected. The Commission, faced at present with a perception that its decisions were "public and obvious demonstration[s] that the protective laws are ineffectual,"<sup>79</sup> now will have a potent tool against infringing imports. The problem left to be resolved, either by Commission interpretation or by further Congressional clarification, is whether the expanded definition is over-inclusive, thus allowing section 337 to become an importer's forum.

#### A. Competitiveness

The proposed definition of domestic industry marks the passage of section 337 from a manufacturing protection statute to a competitiveness statute.<sup>80</sup> Congress has realized that the protection of innovation is necessary if the United States is to remain internationally competitive, thus stronger intellectual property laws are needed to protect innovation.<sup>81</sup> The ad-

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gress intended to protect by section 337, we reverse the ALJ [and find that LCA is not part of a domestic industry protected by this statute.]

*Id.* at 1589-90 (citing *Schaper Mfg. Co. v. U.S. Int'l Trade Comm'n*, 717 F.2d 1368, 1373 (Fed. Cir. 1983)).

79. *Gremlins*, *supra* note 7, at 1606 (dissenting views of Vice Chairwoman Liebler).

80. "The original intent of section 337 was the protection and consequent encouragement of American production, American jobs, American capital from unfair competition from imports." 31 *Pat. Trademark & Copyright J.* (BNA) 331 (Feb. 27, 1986); *see also* *Brandt & Zeitler*, *supra* note 26, at 1606.

81. The proposal arises in an era of general expansion of intellectual property rights. Note, *supra* note 25, at 130. Congress and the Reagan Administration are listening to proposals to protect manufacturing processes as a means of maintaining America's competitive edge. *N.Y. Times*, May 13, 1987, at D1, col. 5. As the sponsor of one proposal has noted, "Our laws must enable United States companies to protect themselves from the foreign manufacturers which steal American-owned technology and then use American innovations to compete with United States-manufac-



ministration argues that innovation has become the foundation of the global industrial and commercial system, and that innovation needs to be encouraged if trade is to prosper.<sup>82</sup>

The amendment will accomplish the goal of promoting competition and innovation by allowing the research and development or licensing of intellectual property to constitute a domestic industry.<sup>83</sup> Domestic computer, biotechnology, and entertainment firms can maintain their competitive edge over importers only if their intellectual property rights are protected.<sup>84</sup> Biotechnology companies in particular go through initial phases where they do little more than develop patents.<sup>85</sup> Costs to American industry due to piracy of intellectual property have been enormous, estimated at between \$8 billion and \$20 billion per year.<sup>86</sup>

The definition's emphasis on competitiveness seems to indicate that Congress intends that the protection of domestic

tured products." Remarks of Senator Dennis DeConcini, *quoted in* N.Y. Times, May 13, 1987, at D1, col.5.

82. Farnsworth, *U.S. Plans to Defend its Patents*, N.Y. Times, Apr. 7, 1986, at D1, col. 6. The argument has been made, however, that protectionism is not the way to bolster competition. John F. Akers, chairman, president, and chief executive officer of IBM, has noted: "The day of easy competition has ended, as we face 19 million Taiwanese, 43 million Koreans, 120 million Japanese, and one billion Chinese who get up at six o'clock in the morning, do calisthenics, and work six days a week for modest wages." Furthermore, he said that U.S. businesses "have been responding to the competitive challenge by seeking easy ways out and 'places to hide'—protectionism and national industrial policy—will not work and should be avoided." 4 Int'l Trade Rep. (BNA) 199 (Feb. 11, 1987).

83. S. 490, 100th Cong., 2d Sess. (1987); H.R. 3, 100th Cong., 2d Sess. (1987).

84. Hurwitz, *Copyrights Are as Vital as Merchandise*, N.Y. Times, Oct. 5, 1986, § 3 (Business Section), at 2, col. 3.

85. When introducing his proposal, Senator Lautenberg pointed out that: For better or worse, we are more and more an information based economy. For those who make substantial investments in research, there should be a remedy. For those who make substantial investments in the creation of intellectual property and then license creations, there should be a remedy.

Let me give one example. There is a startup [sic] biotech firm in my State. Its product is its patents. It hasn't reached the stage to manufacture. It doesn't have the money. But it will reach that point, by licensing its patents to others. Should we deny that firm the right to exclude the works of pirates? Our legislation would say no. A party could get relief if it has made significant investment in R&D, engineering, or licensing.

133 CONG. REC. S1795 (daily ed. Feb. 4, 1987).

Additionally, many biotech firms will require enhanced process patent protection. See Gannes, *The Big Boys Are Joining the Biotech Party*, FORTUNE, July 6, 1987, at 62.

86. Sims, *Wounded By Patent Policy*, N.Y. Times, May 13, 1987, at D1, col. 3.

manufacturing jobs takes second place to competitiveness concerns. Congress's emphasis echoes the sentiment of the ITC's counsel in *Toy Trucks*, who argued that the ITC should not penalize U.S. firms for remaining competitive by moving their manufacturing off-shore.<sup>87</sup> Additionally, although the rationale for protecting licensing companies is that they will eventually provide manufacturing jobs,<sup>88</sup> the proposed definition removes any requirement that they actually do so.

While the definition evinces a clear Congressional mandate regarding competitiveness, the absence of a numerical definition of "significant" leaves the ITC room to again exercise its discretion. The vagueness of what is "significant" makes it impossible to predict with certainty whether a small off-shore manufacturer such as the complainant in *Toy Trucks* will meet the new definition, although commentators have assumed they will.<sup>89</sup> Putting a number on "significant" might become more of a hindrance than a solution in such situations. The *Floppy Disk Drive* decision indicates that the ITC can creatively use its discretionary power.<sup>90</sup> Given the clear goal of enhancing competitiveness, however, it is safe to predict that, on the whole, the American intellectual property holder will constitute a domestic industry under the amended section 337.

#### B. Will Section 337 Become an Importer's Forum?

The ITC will need to exercise attentively its discretionary power in handling the importer's forum issue. As the majority

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87. In a rare move, the Commission's Unfair Import Investigations Division asked the ITC to reconsider its finding in *Toy Trucks*. Dividing its argument against the "nature and significance" test and the manner in which it was applied by the Commission, the ITC staff attorneys warned that "if an American industry decides to contract out manufacturing overseas in order to remain efficient and competitive, it could be forfeiting the availability of protection under § 337 if 'industry' is interpreted too narrowly." *Definition in Vehicles Case Should Be Reconsidered, ITC Division Tells Panel*, Daily Executive Report (BNA) No. 225, at L-2 (Nov. 22, 1982).

This position is similar to that of Schaper's lawyers, who argued on appeal that for the Commission to deny firms relief because actual production, which has become a less significant operation, may occur abroad, is to penalize American business for its capability to adapt to contemporary economic realities. *U.S. Firms Appeal ITC's Negative Ruling on Industry in Toy Trucks Case to CAFC*, Daily Executive Report (BNA) No. 66, at L-3 (April 5, 1983).

88. See Remarks of Senator Lautenberg, 133 CONG. REC. S1795 (daily ed. Feb. 4, 1987), quoted in *supra* note 80.

89. See Farkas & Chubb, *supra* note 11, at 185.

90. See *supra* notes 54-55 and accompanying text.

in *Gremlins* pointed out, anything a licensing company does can be done by an importer. Therefore, a finding that LCA was part of a domestic industry would open the door to foreign importers as complainants.<sup>91</sup> One commentator has suggested that the proposals would allow foreign importers to use section 337 to terrorize each other.<sup>92</sup> The ITC does not have the resources to devote to these disputes.<sup>93</sup> Since fifty percent of U.S. patents are in foreign hands, this is a considerable concern.<sup>94</sup>

If the domestic industry requirement were insufficiently strict, a Japanese company, for example, that owned a U.S. patent but had no established domestic manufacturing operations and merely token research facilities would constitute part of a domestic industry. It could then complain of unfair practices under section 337.<sup>95</sup> The respondent could be a U.S. company that imported the allegedly infringing articles from, say, Hong Kong.<sup>96</sup>

Mediating among importers reduces the ITC's effectiveness in achieving its legislated purpose.<sup>97</sup> Most importantly, the limited resource of section 337's relief will be expended and diverted from the domestic industries that need it, with no appreciable impact on U.S. production capability or U.S. manufacturing employment.<sup>98</sup>

The first solution to the importer's forum problem is imaginative use by the Commission of the public interest clause of the statute.<sup>99</sup> Under the clause, the Commission can choose to limit relief if it appears that granting relief to a complainant

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91. See *Gremlins*, *supra* note 7, at 1589, quoted in *supra* note 73.

92. See Farkas & Chubb, *supra* note 11, at 185.

93. *Id.*

94. Brunsvold & Alberstadt, *Bills Aim to Better Protect U.S. Intellectual Property*, *LEGAL TIMES*, Nov. 11, 1985, at 13.

95. *Id.*

96. *Id.*

97. *House Panel Considers Bills on Intellectual Property and Trade*, 31 *Pat. Trademark & Copyright J.* (BNA) 331 (Feb. 27, 1986).

98. *Id.* at 331.

99. 19 U.S.C. 1337(d) (1982). In testimony before the House concerning amendments to section 337, former Chairwoman Stern testified that requirements, such as the efficient industry requirement, that are removed from the statute may be considered in the public interest determination. See Brunsvold & Alberstadt, *supra* note 94, at 13.

is not in the public interest.<sup>100</sup> It is clearly in the public interest to prevent misuse of section 337, as well as to prevent the reduced competition among foreign goods that could result from such misuse.<sup>101</sup>

A second possible solution exploits the absence of a definition of the word "significant" in section 337.<sup>102</sup> By creating very high thresholds for significant expenditures in intellectual property, the Commission can exclude ostensibly foreign companies and off-shore manufacturers with token domestic investments.

The problem, however, remains that the Commission would have to expend significant resources even to dismiss cases brought by importers. Even if unwanted actions can be disposed of at an early stage, the Commission's docket will still be crowded,<sup>103</sup> thus reducing the attractiveness of section 337 as a speedy remedy.<sup>104</sup> Additionally, the delays caused by increased use of the section 337 remedy would add to the cost of bringing a section 337 action, thereby working against other proposals in the Omnibus Trade Bill aimed at reducing the cost of bringing such an action.<sup>105</sup>

### CONCLUSION

The proposal to define domestic industry in section 337 of the Tariff Act of 1930 marks section 337's passage from a manufacturer's statute to a competitiveness statute. The proposal will make America's nascent intellectual property-based companies eligible for section 337's speedy relief. However, to

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100. The Commission has in the past denied relief for public interest reasons, even after the complainant has satisfied the three elements. Note, *supra* note 25, at 139.

101. See Farkas & Chubb, *supra* note 11, at 185. Antitrust statutes are themselves misused as restraints of trade. Cf. *CVD, Inc. v. Raytheon Co.*, 769 F.2d 842 (1st Cir. 1985), *cert. denied*, 106 S. Ct. 1198 (1986) (dominant firm's bad-faith threats to sue rival for misappropriation of trade secret in order to coerce entrant into licensing agreement constitutes antitrust violation); *Grip-Pak v. Illinois Tool Works, Inc.*, 694 F.2d 466, 468 (7th Cir. 1982), *cert. denied*, 461 U.S. 958 (1983). See generally Hurwitz, *Abuse of Government Processes, The First Amendment, and the Boundaries of Noerr*, 74 GEO. L.J. 65 (1985).

102. See *supra* note 5.

103. Filings would increase from 25 to 75. Brunsvold & Alberstadt, *supra* note 94, at 13.

104. See *supra* text accompanying notes 21-26.

105. See Daily Executive Report (BNA) No. 74, at L-1, (April 17, 1986).

protect America's high technology firms, Congress may have saved the bathwater as well as the baby. The Commission will have to be resourceful in preventing importers from taking advantage of a statute originally drafted to prohibit unfair import practices.

If the definition is adopted, complainants will immediately test the clarity of the new bright-line distinction between importer and domestic industry. Resolution of these cases will aid Congress when they next need to fine-tune section 337. For now, the proposal resolves the definitional struggle the ITC had with domestic industry. Congress has successfully drawn the line against unfair imports.

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